

THE YIELD CURVE

The Federal Reserve Seems Hesitant to Pursue More Monetary Easing, but Pressure Is Increasing

HIGHLIGHTS

- ▶ Bond yields rose slightly in July, as Sino-U.S. trade negotiations resumed and U.S. economic data were generally encouraging. Unsurprisingly, the Federal Reserve (Fed) still ended up lowering its key rates by 25 basis points on July 31 for the first time since December 2008. It also decided to immediately stop shrinking its balance sheet.
- ▶ After clearly signalling monetary easing in July, the Fed appears to want greater leeway for whatever comes next. It has to be said that the positive situation of U.S. households, whose spending jumped 4.3% in the second quarter, does call into question whether a drop in key rates was necessary. In fact, two of the Fed's ten voting members were in favour of maintaining the status quo at the last meeting. The Fed's Chair thus presented July's move as a mid-cycle adjustment in response to greater downside risks and weak inflation, rather than as the start of a lengthy monetary easing cycle. Still, the Fed is keeping the door open to more rate cuts while emphasizing the ongoing uncertainty.
- ▶ President Donald Trump's announcement that a 10% tariff would take effect on September 1 on US\$300B in Chinese exports that had been spared until now from U.S. measures caused significant downside pressure on bond yields and stock markets at the beginning of August. As a result, U.S. and Canadian 10-year yields dropped below 1.70% and 1.20% respectively, levels not seen since the fall of 2016.
- ▶ The Bank of Canada (BoC) opted to maintain the status quo at its July meeting. The Canadian monetary authorities are worried about international tensions harming trade and investment, but also note that financial conditions have eased significantly, which should support the real estate sector. Furthermore, inflation in Canada remains very close to the target level, and everything is pointing to a strong rebound in economic growth in the spring after two difficult quarters.
- ▶ The European Central Bank, wanting to prevent the euro from appreciating under the current circumstances and acknowledging that European economies are continuing to struggle, clearly signalled its intention to ease its monetary policy soon. The rate paid on deposits should drop further into negative territory in September, and a new securities purchasing program could be announced.

INTEREST RATE FORECASTS

- ▶ The international uncertainty, including trade conflicts and the risk of a Hard Brexit, is expected to persuade the Fed to reduce its key rates for a second time before the end of the year, most likely in September. After that, it should return to a more neutral tone, especially since the new tariffs threaten to cause inflation to rise. Bond yields are expected to increase somewhat between now and the end of the year as expectations of further monetary easing remain excessive.
- ▶ The Fed would have to act more aggressively, or the economic situation would have to deteriorate markedly, for the BoC to contemplate easing its monetary policy in turn. We still expect Canadian key rates to remain unchanged for an extended period.

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TABLE 1
Key interest rates

END OF PERIOD IN %	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	1.75	2.00	2.25	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
Canada												
Overnight funds	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Zone euro												
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom												
Base rate	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Japan												
Main key rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

TABLE 2
Fixed income market

END OF PERIOD IN %	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	1.73	1.93	2.19	2.45	2.40	2.12	1.85	1.90	1.90	1.90	1.90	1.90
Federal bonds												
2-year	2.27	2.53	2.82	2.51	2.29	1.76	1.70	1.80	1.90	1.95	2.00	2.00
5-year	2.55	2.73	2.95	2.49	2.23	1.76	1.65	1.80	1.95	2.00	2.05	2.05
10-year	2.75	2.86	3.06	2.69	2.41	2.00	1.85	2.00	2.10	2.15	2.20	2.20
30-year	2.97	2.99	3.21	3.02	2.82	2.53	2.40	2.50	2.55	2.60	2.60	2.60
Yield curve slopes												
5-year - 3-month	0.82	0.80	0.76	0.04	-0.17	-0.36	-0.20	-0.10	0.05	0.10	0.15	0.15
10-year - 2-year	0.47	0.33	0.24	0.18	0.13	0.24	0.15	0.20	0.20	0.20	0.20	0.20
30-year - 3-month	1.24	1.06	1.02	0.57	0.42	0.41	0.55	0.60	0.65	0.70	0.70	0.70
CANADA												
Treasury bills												
3-month	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.65	1.70	1.70	1.70	1.70
Federal bonds												
2-year	1.77	1.91	2.21	1.86	1.55	1.47	1.40	1.50	1.60	1.65	1.70	1.70
5-year	1.96	2.06	2.33	1.88	1.52	1.39	1.30	1.45	1.60	1.70	1.75	1.75
10-year	2.09	2.17	2.42	1.96	1.62	1.46	1.35	1.50	1.65	1.75	1.80	1.80
30-year	2.23	2.20	2.41	2.18	1.90	1.68	1.60	1.70	1.80	1.90	1.95	1.95
Yield curve slopes												
5-year - 3-month	0.86	0.80	0.74	0.24	-0.15	-0.27	-0.35	-0.20	-0.10	0.00	0.05	0.05
10-year - 2-year	0.32	0.26	0.21	0.10	0.07	-0.01	-0.05	0.00	0.05	0.10	0.10	0.10
30-year - 3-month	1.13	0.94	0.82	0.54	0.23	0.02	-0.05	0.05	0.10	0.20	0.25	0.25
Yield spreads (Canada—United States)												
3-month	-0.63	-0.67	-0.60	-0.81	-0.73	-0.46	-0.20	-0.25	-0.20	-0.20	-0.20	-0.20
2-year	-0.50	-0.62	-0.61	-0.65	-0.74	-0.29	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
5-year	-0.59	-0.67	-0.62	-0.61	-0.71	-0.37	-0.35	-0.35	-0.35	-0.30	-0.30	-0.30
10-year	-0.66	-0.69	-0.64	-0.73	-0.79	-0.54	-0.50	-0.50	-0.45	-0.40	-0.40	-0.40
30-year	-0.74	-0.79	-0.80	-0.84	-0.92	-0.85	-0.80	-0.80	-0.75	-0.70	-0.65	-0.65

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2019 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
9	Bank of Canada*	s.q.	1.75
22	Bank of Japan	s.q.	-0.10
23	Bank of Korea	s.q.	1.75
24	European Central Bank	s.q.	0.00
24	Bank of Norway	s.q.	0.75
30	Federal Reserve	s.q.	2.50
February			
4	Reserve Bank of Australia	s.q.	1.50
6	Bank of Brazil	s.q.	6.50
7	Bank of England	s.q.	0.75
7	Bank of Mexico	s.q.	8.25
12	Reserve Bank of New Zealand	s.q.	1.75
13	Bank of Sweden	s.q.	-0.25
27	Bank of Korea	s.q.	1.75
March			
4	Reserve Bank of Australia	s.q.	1.50
6	Bank of Canada	s.q.	1.75
7	European Central Bank	s.q.	0.00
14	Bank of Japan	s.q.	-0.10
20	Bank of Brazil	s.q.	6.50
20	Federal Reserve	s.q.	2.50
21	Bank of England	s.q.	0.75
21	Bank of Norway	+25 b.p.	1.00
21	Swiss National Bank	s.q.	-0.75
26	Reserve Bank of New Zealand	s.q.	1.75
28	Bank of Mexico	s.q.	8.25
April			
1	Reserve Bank of Australia	s.q.	1.50
10	European Central Bank	s.q.	0.00
17	Bank of Korea	s.q.	1.75
24	Bank of Canada*	s.q.	1.75
24	Bank of Japan	s.q.	-0.10
25	Bank of Sweden	s.q.	-0.25
May			
1	Federal Reserve	s.q.	2.50
2	Bank of England	s.q.	0.75
7	Reserve Bank of Australia	s.q.	1.50
7	Reserve Bank of New Zealand	-25 b.p.	1.50
8	Bank of Brazil	s.q.	6.50
16	Bank of Mexico	s.q.	8.25
29	Bank of Canada	s.q.	1.75
30	Bank of Korea	s.q.	1.75
June			
4	Reserve Bank of Australia	-25 b.p.	1.25
6	European Central Bank	s.q.	0.00
13	Swiss National Bank	s.q.	-0.75
19	Bank of Brazil	s.q.	6.50
19	Bank of Japan	s.q.	-0.10
19	Federal Reserve	s.q.	2.50
20	Bank of England	s.q.	0.75
20	Bank of Norway	+25 b.p.	1.25
25	Reserve Bank of New Zealand	s.q.	1.50
27	Bank of Mexico	s.q.	8.25

Date	Central banks	Decision	Rate
July			
2	Reserve Bank of Australia	-25 b.p.	1.00
3	Bank of Sweden	s.q.	-0.25
10	Bank of Canada*	s.q.	1.75
17	Bank of Korea	-25 b.p.	1.50
25	European Central Bank	s.q.	0.00
29	Bank of Japan	s.q.	-0.10
31	Bank of Brazil	-50 b.p.	6.00
31	Federal Reserve	-25 b.p.	2.25
August			
1	Bank of England	s.q.	0.75
6	Reserve Bank of Australia	s.q.	1.00
6	Reserve Bank of New Zealand	-50 b.p.	1.00
15	Bank of Norway		
15	Bank of Mexico		
29	Bank of Korea		
September			
3	Reserve Bank of Australia		
4	Bank of Canada		
5	Bank of Sweden		
12	European Central Bank		
18	Bank of Brazil		
18	Bank of Japan		
18	Federal Reserve		
19	Bank of England		
19	Bank of Norway		
19	Swiss National Bank		
24	Reserve Bank of New Zealand		
26	Bank of Mexico		
October			
1	Reserve Bank of Australia		
16	Bank of Korea		
24	European Central Bank		
24	Bank of Sweden		
30	Bank of Brazil		
30	Bank of Canada*		
30	Bank of Japan		
30	Federal Reserve		
November			
5	Reserve Bank of Australia		
7	Bank of England		
12	Reserve Bank of New Zealand		
14	Bank of Mexico		
28	Bank of Korea		
December			
3	Reserve Bank of Australia		
4	Bank of Canada		
11	Bank of Brazil		
11	Federal Reserve		
12	European Central Bank		
12	Swiss National Bank		
18	Bank of Japan		
19	Bank of England		
19	Bank of Norway		
19	Bank of Sweden		
19	Bank of Mexico		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively. * Monetary Policy Report published; ** To be determined.